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The American Institute of Certified Public Accountants: A Century of Progress and Commitment to the Accountancy Profession

THE AICPA: A PROFESSIONAL INSTITUTION IN A DYNAMIC SOCIETY

The American Association of Public Accountants was formed in 1887 as a new era in American history was dawning. In this new society, science, technology and business often merged in developing new techniques to tap the nation's resources more efficiently. The new urban-industrial setting required new forms of expertise and specialized knowledge. With the help of the American Institute of CPAs and its predecessors, public accounting came to fill a unique and essential role in American society.

The AICPA's contributions in developing public accountancy are enormous. Raising the quality of accounting practice has always been essential to the AICPA's purpose. To achieve this goal the Institute has had to maintain a delicate balance between flexiblility and standardization — flexibility to allow improvements in accounting methods, and standardization to create stability and public confidence in the accounting profession. Through the three standard-setting boards and its encouragement of research, the Institute has created a body of technical knowledge; by its educational and experience requirements and its Code of Ethics, the AICPA has worked to meet the accounting profession's social responsiblilties.

LEADERS OF THE ACCOUNTING PROFESSION FOURTEEN WHO MADE A DIFFERENCE

In the article the author commemorates the contributions of 14 leaders who have bettered the profession over the first century of American accounting. Of these 14, four men are highlighted: Robert H. Montgomery, George O. May, William A. Paton and Carman G. Blough.

Robert H. Montgomery was a primary figure in the development of the Institute at critical points in its history. His many accomplishments include buying a state society's journal and renaming it the *Journal of Accountancy*, and serving as president of the Association from 1912-1914 and of the Institute during the 1930s.

George O. May was indispensable in raising the standards of accounting and auditing practice during the 1930s. His incisive, perceptive commentaries on the issues of the day contributed to the rise of the accounting profession in American society.

William A. Paton was a pioneer in the field of accounting theory. His contributions include founding *The Accounting Review* and expanding the influence of the American Accounting Association.

Carman Blough, the Securities and Exchange Commission's first chief accountant worked to encourage the accountancy profession to establish "substantial authoritative support" as the conceptual basis for a body of knowledge. He also served as president of the American Accounting Association, was a member of the Committee on Accounting Procedure and became the Institute's first full-time director of research.

The other ten leaders discussed are Andrew Barr, Samuel J. Broad, John L. Carey, Paul Grady, Eric L. Kohler, A. C. Littleton, Weldon Powell, Leonard Spacek, Charles E. Sprague and William W. Werntz.

ETHICS

Throughout the 100-year existence of the American Institute of Certified Public Accountants, one of the most important concerns of the Institute has been to maintain its professionalism through the establishment of high ethical standards. The present Code of Professional Ethics is the result of the accounting profession's response to itself, its clients, regulatory bodies, and financial statement users over the past century.

Four areas in particular have been the subject of great controversy within the profession: independence, advertising and solicitation, commissions, and contingent fees. All four were dealt with in the early days of the AICPA, and all four are dealt with in the recently issued Report of the Special Committee on Standards of Professional Conduct for Certified Public Accountants. The article discusses the developments associated with each of the four areas over the 100-year history of the AICPA.

As the Institute enters its second century of existence, we should take pride in the fact that the accounting profession is as concerned with maintaining high professional standards today as it was 100 years ago, when the first public accounting association in the United States was formed.

THE DEVELOPMENT OF STANDARDS

Goethe once referred to double-entry accounting as "one of the finest inventions of the human spirit." Throughout the history of accountancy in America, accountants have developed accounting and auditing standards to make this "finest invention" play as useful a role in society as possible. The article discusses the role of accounting in the early days of American industrialization, the ensuing demand for authoritative standards and the recent development of accounting and auditing standards.

The early development of American industry from 1887-1903 was a period in which the auditing function gained acceptance and importance. The first auditor's certificate for U.S. Steel in 1903 was a turning point in financial reporting, but the next 35 years were a relatively stagnant period for the development of effective accounting and auditing standards. Beginning in 1938, however, with the establishment of the Committee on Accounting Procedure, the accounting profession began to take advantage of the standard-setting authority granted by the SEC. The Accounting Principles Board and Financial Accounting Standards Board have since taken over the role of the committee in setting generally accepted accounting principles. As for auditing standards, the Committee on Auditing Procedure was set up by the Institute in 1939 in response to the McKesson and Robbins scandal. AudSEC and ASB have since succeeded the committee as promulgators of GAAS.

CORPORATE FINANCIAL REPORTING AT THE TURN OF THE CENTURY

The turn of the century was an important period in the development of accounting thought and practice, especially in auditing. It was a time of growth for the accounting profession because the accounting firms that would eventually comprise the Big 8 were formed and states were beginning to pass CPA laws. It also was the era of the "Big Trust," and companies such as American Telephone & Telegraph, Du Pont, General Electric, U.S. Steel and Westinghouse were on the rise.

The big corporations were criticized for their poor or nonexistent financial reporting practices as accountants pushed for better disclosure and widespread independent auditing. An academic publication quoted the Bible, John 3:19, "Men loved darkness rather than light, for their deeds were evil." Under pressure from investors, the public and the accounting profession, corporations gradually came to accept annual independent audits and began to publish their financial statements in stockholders' reports.

The article shows the progress that was made during the period by excerpts from auditors' reports and financial statements from the turn of the century.

THE ROLE OF THE CPA IN TAX PRACTICE

Since the inception of the income tax in the United States the accounting profession has played an important role in the development and interpretation of the income tax laws. Accountants' involvement in income taxation came about due to the nature of the tax: In order to tax income, income must be defined; because one goal of financial accounting is to determine income, the role of the accounting profession seems obvious in retrospect.

As income tax laws became increasingly complex, tax accountants' knowledge became more and more important to corporations and capital-intensive taxpayers. Today, especially with the enactment of the Internal Revenue Code of 1986, the tax laws are too complex to be comprehended by the general public. The expertise of tax accountants is needed to help clients understand and minimize their tax liability.

Tax practice is divided into three segments: public accounting, private or corporate accounting, and government practice. Each segment performs a different role in providing a liaison between taxpayers and the income tax laws.

The income tax has become an intrinsic part of American society. In addition, it has become an intrinsic part of the accounting profession. A significant portion of almost all accounting firms is devoted to tax practice. With the enactment of the Tax Reform Act of 1986, the importance of tax accountants will inevitably increase over the next few years.

AUDIT TECHNOLOGY: A HERITAGE AND PROMISE

Audit technology is the "toolkit," with which auditors perform their audit tasks. Many of the tools in the toolkit, such as basic auditing concepts and many auditing procedures, are abstract. The article discusses the technology of independent audits of financial statements.

"Uniform Accounting," published in 1917, compiled the audit procedures of the day. In the publication the concept of reliance on controls is discussed to distinguish the audits of large versus small or medium-sized businesses.

After the McKesson & Robbins case the Institute issued *Extensions of Auditing Procedures,* which made internal control evaluation mandatory and required the observation of physical inventory and confirmation of receivables.

In the recent years, statistical audit sampling has evolved into an accepted audit tool and the computer has become an essential auditing aid, especially with the current development of expert systems.

As for the future the authors envision a world in which users of financial statements create their own financial reports by access to company databases. The primary focus for an audit would be control risk assessment because users couldn't obtain reliable reports without adequate controls over the database.

THE SCOPE OF CPA SERVICES

The scope of services performed by CPAs includes accounting and auditing, management advisory services and taxation. These diverse areas of specialization have evolved over the past century in response to the growing needs of society. Prior to the Civil War the services needed from accountants were not as varied as those that came about during the period of industrialization. As railroads, steel mills and manufacturing companies emerged, the calculations needed to prepare financial statements became very complex. Accountants were needed for more than simply bookkeeping tasks.

The passage of the corporate and personal income tax laws in the early 1900s provided substantial opportunities for CPAs to develop an additional valuable service — taxation. The next set of laws beneficial to the accounting profession was passed in the 1930s. Attest services were now required to be performed on publicly held companies. In addition, the rush of work and shortage of personnel during World War II allowed CPAs to apply their skills and expand their involvement into new areas of consulting. As a result, management services grew rapidly in the 1950s.

With the addition of consulting services the issue of independence became a subject of increasing discussion. The securities laws required independence, and a controversy arose over whether there would be a conflict of interest if a CPA performed the attest function and provided consulting services. The profession is continually reviewing ways to maintain independence. All personnel in a CPA firm are subject to the same independence requirements when providing service to publicly held companies, regardless of their particular specializations. Therefore, the profession should be presented as a unified set of services rather than split into three distinct areas of specialization. To continue to develop the CPA's role as an independent information professional the following initiatives are being emphasized:

1. Continued emphasis on the attest function independence as the cornerstone of the profession.
2. Demonstration of how the skills developed in the performance of nonattest services complement a firm's attest skills and improve the quality of its auditing.
3. Organization of practice units across functional lines. (Integrate the personnel in auditing, taxation and management advisory services.)
4. Changes in the education and testing of future CPAs. Accounting and information systems should be taught more as complementing curricula.

CONTINUING PROFESSIONAL EDUCATION 1887-1987

One of the most important developments in the history of the AICPA is the continuing professional education program. Prior to World War II, very few formal programs of continuing education existed. In 1958 $50,000 was appropriated to start the continuing education project, now known as Continuing Professional Education. The project started with less than 2,000 participants and is now a $17 million operation serving 200,000 participants annually.

During the early years of the program, it was decided that the Professional Development Division would prepare the instructor/participant manuals and promotional brochures; and the states would engage the discussion leader, promote the program, arrange for the presentation site and take care of the other administrative details. A portion of the participant fee was given to the state society and called a "co-sponsorship" fee. Although there was some competitive tension between the state societies and the Professional Development Division, the number of programs and enrollment rose rapidly.

Continuing education was completely voluntary until Marvin L. Stone, 1967-68 President of the AICPA, urged the states to require continuing education. The Iowa State Board of Accountancy was the first state to adopt Stone's suggestion and to date

48 of the 54 CPA licensing jurisdictions have a requirement for continuing education. It is hoped that by the year 2000 all AICPA members will be required to participate in the education programs.

THE CPA IN INDUSTRY AND BUSINESS

For the first time, AICPA members in industry and other nonpractice segments outnumber those in public practice. CPAs in industry play a vital role in American business. Many large businesses are electing CPAs as chairmen, presidents and chief executive officers. The excellent opportunities available in business are attracting college graduates directly to business rather than to public accounting. Therefore, it is very important that the AICPA address the issues facing CPAs in business and industry, and encourage industry CPAs' participation in the Institute.

The AICPA should monitor the work performed by CPAs in industry. Companies hiring CPAs may alleviate some of the litigation problems facing CPAs in public practice. The trend has been for the public to hold auditors responsible for failure to detect problems. However, if qualified CPAs in industry were to prepare financial statements with the AICPA insisting on technical proficiency and adherence to the Institute's Code of Ethics (except for independence), it's possible that many court cases could be avoided.

The Institute has recognized the impact of the growing number of members who are industry CPAs. About half of the AICPA committees now have a member from industry. Also, the Institute has made great strides in adding continuing professional education courses that are oriented toward industry.

CPAs in industry and business have become very important to the accounting profession. Participation by both public and nonpublic accountants in the Institute will enhance the profession and, therefore, serve the public interest.

FEDERAL FINANCIAL MANAGEMENT

The American colonies borrowed their financial administration policies from Great Britain. From the principles of Magna Carta, the colonists guarded against any individual having sole power over public funds. In 1789, Alexander Hamilton, the first secretary of the Treasury, was the creator of America's early financial management systems. An ardent believer in strong central control, Hamilton's system was one of elaborate checks and balances that eliminated almost all fraud; however, the system wasn't very efficient. Moreover, in addition to being inefficient, Hamilton's system was so complex that even congressmen were unable to understand it.

Hamilton's system continued to be used until the end of World War II when Lindsay Warren, the comptroller general, decided to decentralize government accounting. The General Accounting Office (GAO) set financial system standards and then audited the system — not the transactions. It was during this period that the GAO and the accounting profession developed a positive relationship, and there followed great numbers of CPAs who accepted important federal positions. The next major change in federal management was the decision by Congress to allow public accounting firms to perform audits of governmental functions.

Although the decentralized structure was essential in the 1940s and 1950s it seems to be the source of many of the government's problems today. The system is incredibly complex and doesn't meet the needs of society. A few problems with the present federal financial management system are:

1. Lack of cost information.
2. Lack of reliable information on major weapon systems.
3. Inadequate disclosure of costs and liabilities.
4. Unstructured planning for capital investment.
5. Antiquated systems.

In 1983 the GAO formed a task force to study the problems facing the federal government. The task force is being helped by two public accounting firms, and it is hoped that a new structure of federal financial management will be established.

THE SEARCH FOR ACCOUNTING EDUCATION'S IDENTITY

Over 100 years ago the accounting profession set a goal of creating a professional school of accountancy, using schools of medicine and law as models. In 1892 a professional accounting school was actually started, but was unsuccessful and lasted only two years. The efforts to found a professional school were not in vain, however, as they led to state laws establishing the designation of "certified public accountant." To further progress the profession, it was necessary that professional accountants and educators be certified by a professional school of accountancy or, at the very least, pursue a mandatory postgraduate accounting program.

Since the 1950s the AICPA has advocated a postgraduate accounting education as a requirement to become a member of the Institute. Unfortunately though, there has been little support for this goal from state societies and state boards of accountancy.

In addition, academic accountants haven't met the call to provide a more professional curriculum. Educators seem to be more concerned with meeting research standards in order to obtain promotion and tenure. Nor has the public accounting profession encouraged a postgraduate program, as is evidenced by its recruiting patterns.

To develop a more professional identity for accounting education, the following recommendations have been suggested:

1. Establish programs for integrating accounting educators into the professional activities of the AICPA and the state societies.
2. Place greater emphasis on additional liberal arts and business education to provide a better foundation for the professional accountants of tomorrow.
3. Encourage an independent organization to prepare an in-depth study of accounting education to provide an objective view of the current status of accounting education and how it must evolve to support the accounting profession of the future.

WOMEN IN ACCOUNTING

Although the large number of women in accounting is a recent development, women have been a part of the profession since its inception in the United States. For example, recordkeeping was considered an acceptable occupation for women throughout the 17th and 18th centuries. On December 27, 1899, Christine Ross became the first woman to earn the designation of "CPA". By 1910 a total of ten women had received their certificates.

During the 1920s only a few women were studying accounting, as the field was considered a man's profession. The women entering the profession were doing so only with the smaller firms. By the 1950s, most public accounting firms still wouldn't hire women because they weren't considered career-minded or suitable for travel. However, a few women who graduated with high marks in accounting were able to break down the barriers and enter the large firms. With the 1960s came legislation favorable to women; however, it wasn't until the 1970s that the passage of the affirmative action laws had a significant impact on women entering the field of accounting.

Today the accounting profession is working to change the false perceptions of women and to develop more flexible ways to a "career path". Several of the large accounting firms have begun to implement policies (such as four-day work weeks and flextime) that are more conducive to women who wish to stay on the partnership track while raising families. The AICPA recognizes the lack of upward mobility for women and is now studying ways to improve the problem. The challenge of the woman CPA is to provide the leadership necessary to ensure the stability of the profession and meet the opportunities of the changing business world.

THE LITIGATION BOOM

The recent rise in the level of litigation in this country is causing great concern among professionals. Since 1960 the number of federal civil actions filed annually has increased five times. Those hit hardest by this legal trend are the "repeat players" in the system. (Repeat players are companies that deal with a large number of people over a long period of time, such as public accounting firms.)

Accountants are now suffering through the same kind of litigation trends as doctors. The public, which has long expected the medical profession to be infallible, is now expecting accountants to provide infallible audit reports. In the past the public has relied on accountants' reputations for integrity, independence and scrutiny. Along the way, the public has transformed the meaning of "accountant" into a "guarantor of safety." Accountants are now expected to insure that no risk is passed on to the investing public. It is no surprise, then, that accountants have found themselves in the courtroom.

There are three classes of claims facing the accountant in the courts:

1. The wrong accounting principle was applied.
2. Management and the accountant conspired to deceive investors/creditors.
3. "Someone should have told me." (Something that someone thought was important wasn't disclosed.)

The third classification is the real trouble area for accountants. In these cases, accounting firms tend to settle out of court because they have serious doubts over what juries might think is important.

There is a major concern that increased litigation will drive up the cost of an audit. The higher cost may cause the accountants' services to be less accessible to clients, hinder accounting innovation and chill porfessional judgment. Accountants must become more involved in providing the public with a realistic notion of what audits involve and of what accountants can realistically be expected to do. The courts and the public must be convinced that society is not well served when accounting firms must pass the costs of litigation on to their clients.

THE PROFESSION — 2000 AND BEYOND

There are three major studies that are under consideration in our 100th year. The study and implementation of these items will carry the accounting profession into the 21st century. The studies are: the AICPA mission statement, the Anderson Committee recommendations, and the Treadway Commission.

The mission of the AICPA is to act on behalf of its members and to provide the necessary support to insure that CPAs serve the public interest in performance, quality, and professional service. The means for achieving this mission are licensing and certification, professional competence, standards of professional conduct, and monitoring practice. Educational programs unite CPAs from all segments of practice and assist members in understanding the economic, political, and technological environment in which they practice.

Secondly, the Anderson Committee has made recommendations in three important areas: 1) Code of professional ethics which introduces senior technological recommendations and performance standards into the code. 2) Programs for monitoring practice and improving compliance with performance standards. Here the committee has recommended a program to monitor practice, improve quality and to reduce the incidence of substandard work. The basis for implementing this recommendation is a quality review program. 3) Recommendation of the Anderson Committee relating to educational requirements. The linkage of higher educational requirements is seen in this recommendation of 150 hours post-baccalaureate requirement. The early leaders of our profession who emphasize collegiate education, the Andersons, the Haskins, the Sells and the Montgomerys established roots in both education and the practicing profession and they might very well smile on this new forward thrust in accounting education.

The third area, the Treadway Commission will make recommendations regarding auditing standards, detecting fraud, the auditor's role and responsibility, quality assurance programs, independence and the auditing committee, and other leaders' professional requirements to maintain the integrity of the roll of auditor in our society.